RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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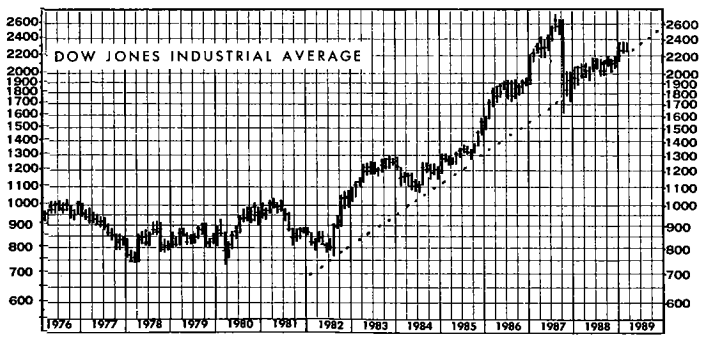
April 19, 1989 **LETTER 1015**

April 7 DJIA 2304.80; PTI 2963; A-D Ratio -9.94
April 14 DJIA 2337.06; PTI 2976; A-D Ratio -9.56
Dow Current Yield: 3.57%; Dow P/E: 10.8
Dow Book Value: 1009; Dow MA: 2170
DowPow: 713
Percentage of Undervalued Blue-chips: 20%

THE PICTURE: "Be simple," wrote the great Russian author, Dostoevski, "and rediscover the world." Even on Wall Street it often pays to take the simple approach. Here's a monthly chart of the Dow (courtesy of *United & Babson Investment Report).* The chart is drawn to ratio scale which means that any rising trendlines on the chart will show a fixed rate of growth. Break a rising trendline, and the chart will signal a reversal in the rate of growth.



I've drawn a trendline from the 1982 low through the 1984 and '85 lows. That trendline depicts the Dow's growth rate from the 1982 low to the 1987 high. The 1987 crash took the Dow temporarily below the rising trendline. But the post-crash recovery shows the Dow literally walking up the rising growth-rate trendline. For a breakdown and reversal of the growth rate, the Dow would now have to drop decisively below the 2100 level.

Since late-January the Averages have been locked within the confines of a fairly tight trading range. The upper limits of the trading range are Dow **2347.14** and Transports **1087.97.** The lower limits of the trading range are Dow **2243.04** and Transports **1008.09.** The next major direction of the stock market will be signaled by BOTH Averages breaking out -- either above or below their trading range limits. I might add that the LONGER the Averages hold within their trading range, the more important the ultimate breakout will be.

An analysis of the 30 Dow Industrial shares shows that there are currently only 10 Dow Industrials that qualify for a bullish designation (at least according to my system). To classify a stock as bullish I require that the stock show positive relative strength (RS) and at the same time that stock must be above its 30-week moving average (MA). On that basis, the following Dow stocks are bullish: Aluminum Co.; Amer. Express (but just barely); Amer. Tel.; Bethlehem Steel (hanging just above its MA of 24); Boeing; Chevron (RS just making it); Coca-Cola; Merck; Texaco; Union Carbide.

Bearish and deteriorating technically are: Kodak; Exxon; Gen. Electric; Gen. Motors; IBM; Int'l. Paper. Showing improvement but still not clearly bullish are: Du Pont; McDonalds; Proctor & Gamble; Sears; United Technologies.

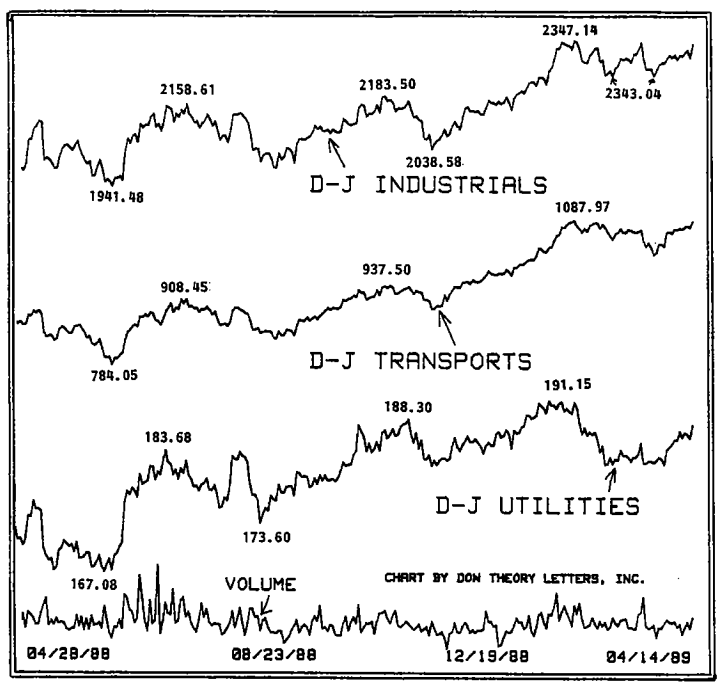
PERSPECTIVE: I've said this a few times before, but I might as well repeat it -- ever since the 1987 bear signal and crash I felt that the stock market was headed for another very difficult and confusing period, a period much like 1966-74. What was the 1966-74 era like? Here's a short history.

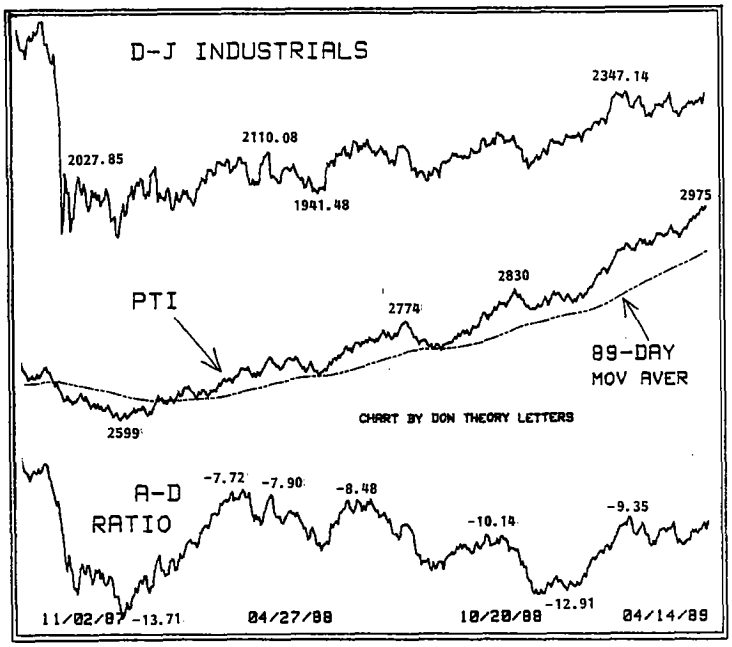
A great bull market topped out on February 9, 1966 with the Dow at 995.15 and Transports at 271.72. Following the '66 high, the market caved in with the Dow hitting a low of 744.32 in October of that same year. Powerful advances were seen during the following years, 1967 and 1968, although at no time did both Averages better their 1966 highs together. Then in 1969 the market suffered another vicious collapse with the Dow hitting a low of 769.63 in December of '69. The years 1971 and '72 witnessed a series of erratic rallies and declines. In January 1973 the Dow surged to a record high of 1051.70, but the Transports failed by a wide margin to confirm. From the '73 highs the market headed down into what was to be the worst bear market smash since the 1930s.

In retrospect, you could label the whole 1966-74 period as a series of mini bull and bear markets. Or you could call the period a single, extended, and very complex bear market, a bear market which hit its final low in late-1974. Frankly, as I review this very difficult period I wonder how I ever lived through it. A lot of trading money was made during 1966-73 but in the end the 1973-74 collapse wiped out all of the gains and more -- and sent a lot of traders and Johnny-come-lately investors back to waiting on tables or selling used cars.

Unfortunately, I didn't have my Primary Trend Index (PTI) in 1966, and it wasn't until 1971 that I finally developed this extraordinarily helpful instrument. In 1971 I started publishing statistics on the PTI, and from that point on my life became a good deal easier.

To review the PTI action of the 1970s, the PTI hit a peak in February of 1972, sagged, then rallied to a lower peak in January





of 1973 (thereby refusing to confirm the new record high in the Dow). From its January '73 peak the PTI started on a long path down. The PTI continued its relentless descent for almost two years or until December 1974. During its 1973-74 decline the PTI lost a total of 927 points, the worst decline in its 18-year history.

As stated, I began using the PTI in 1971, but at that time I didn't have any previous history to test the PTI with. Today, with almost two decades of history behind it, I'm able to place an awful lot of faith in the action of my PTI. And despite my trepidations and despite my opinion that we're in a long-term primary bear market, the PTI continues to push to new highs, and the Averages continue to follow the PTI up.

Ultimately, we'll see the time when the PTI will stall out and start down. My feeling (based on past action) is that when the PTI finally reverses itself and traces out a declining trend, that trend will persist for quite a long time -- perhaps a few years or even longer. Since January 1988 (when it first turned bullish) the PTI has come down to test its moving average on several occasions. Each time the moving average has proved to be strong support, following which the PTI ran up to new highs.

INVESTMENT POSITION: The bond market remains impressively resistant to any important declines, and with the recent bond rally the juicy short-term rates that I recommended have backed off some. Thus, those of us who recently locked in T-notes maturing in 2 to 4 years (with yields of over 9.6%) probably captured bargains.

On the stock front, my PTI just won't quit -- it continue to make new highs (see chart above), and that tells us that the technical understructure of the stock market continues bullish. The ratio of stock yields (3.7%) vs. T-bill yields (8.7%) is now 2.3 in favor of the bills -- which is still high risk for the stock market.

Good-quality bonds are holding up quite well, despite the big moves in the Producer Price Index and despite the inflation fears (see MONEY section on page 6).

MONEY: It is known that Alan Greenspan wants the federal budget deficit reduced to zero and ultimately -- he wants surpluses. Alan also wants not 5%, not 3% -- but 0% inflation. At the same time Alan also wants to avoid a recession. How can all this be brought about? Darned if I know.

The Fed has very gingerly raised the Fed Funds rate -- actually they merely followed along behind the market rates which have been rising on their own. Currently, the discount rate is only 7%, about 1.5% below where it should be. On top of that, money has been made abundantly available -- you simply have to pay for it. In other words, the Fed has been mostly hard talk and soft action.

In the meantime, the US unemployment rate has dropped to a decade low, consumer debt rose $4.2 billion in February, unfilled order books are bulging, factory utilization is at a peak, retail sales continue fairly strong, and inflation has now developed into a global problem with almost every major nation suffering rising prices.

Can the Fed lower the inflation rate with a gentle half-squeeze on the money markets? History says no. But the primary trend is down, and that may mean that it will take considerably less pressure than it ordinarily would to send the economy into the tank.

In the meantime, short rates have dropped off a bit, and the bonds continue to act remarkably well. In this investing business, I often listen to my stomach rather than my head. So far, I've had no painful signals from my stomach telling me to dump my bonds.

A final thought -- Will a recession hit by year-end? Are we already in a recession? Will there be a recession at all? The biggest guessing game around is trying to figure out what's happening in the economy and when and where. Every economist has his own script. The stock market, evidently, has not made up its mind -- which probably accounts for the Dow being locked in a tight trading range of 104 points for the last three months.

Oh yes, the latest theory is that we are heading for "stagflation." A number of very smart guys think we're already there. Would Greenspan and the Fed stand for stagflation (i.e., an economy moving sideways while inflation continues at a rate of say 5-6%)? Yeah, probably. With the Bush administration acting totally wimpy and leaderless on the federal deficit, I frankly don't think the Fed knows what to do -- except react to whatever the stock market and the economy do next.

JULIAN and ME: Here's the latest via FAX from Julian Snyder out of St. Moritz, Switzerland. Julian is a brilliant observer of the world scene, and I always find what he writes of extreme interest.

"Dear Dick: I went up to the Bank of International Settlements (BIS) in Basel the other day to sit with a very high banking official, a man I have known for years. The BIS (with assets of $75 billion) is owned by governments and sponsors monthly meetings, largely unpublicized, of the world's central bankers and finance ministers (including Alan Greenspan, who flies in for the meetings). The BIS possesses an excellent view of the world situation. On the basis of my visit, I can tell you that the central bankers of the world (most of whom reached their maturity during the 1970s), are genuinely concerned about inflation and, in my opinion, would be quite likely to overreact to any acceleration of the inflation numbers.

"Yet early drafts of the IMF's latest world economic forecast suggest that the inflation rate this year will average only about 3.7%, which is a far cry from the double-digit inflation of the 1970s. This may mean that despite inflation scares from time to time, we still have a long way to go before inflation really heats up and the central bankers begin to take action.

"Last year this same banking official told me that the only thing that would cure the US trade deficit would be a recession; yet current market and political pressures are against the Fed squeezing decisively enough to break the US economy and bring on recession.

"If the Fed raises interest rates too rapidly the dollar will strengthen too much, and this will worsen the trade situation, thereby forcing

Germany and Japan to raise their own rates (which they are not keen on doing). A further fall in the dollar, on the other hand, would be read as inflationary, which the central bankers fear. A recession also obviously would be disastrous for the thrift situation in the US and for the overburdened Leveraged Buyout crowd. Hence the tendency to stall and to put off major decisions. Yet what few Americans seem to realize is the strangeness of a situation where an overheated or fundamentally weak economy tends to produce a strong international currency as its interest rates rise or are forced up! These rising interest rates draw in foreign investments, and this in turn keeps the game going despite the high US trade deficits.

"The game can't go on forever, but it points toward a potential collapse somewhere down the road. Suppose, for instance, that the Fed continues to raise rates and more money pours in, further encouraging the boom and making it possible to handle deficits more easily. At some point the rates get too high, the economy cracks, and interest rates fall. The conventional wisdom then states that it is time to load up on bonds. But at this point the dollar, without interest rate support, will fall. Somewhere along the line, as we all know, the Fed would literally 'print' money in an effort to revive the economy. All of which most European gurus and traders would take as highly inflationary.

"At this point we arrive at *International Moneyline's* long-held forecast of a inflationary depression. Dick, as a bond advocate, how do you feel about this scenario? Do you really believe the dollar will strengthen in a US recession or depression -- or that bonds will soar if the dollar goes into the tank?"

Russell response: First, let me suggest that all my subscribers read Bob Bleiberg's stinging editorial in the April 3 *Barron's*. What Bleiberg says is that Greenspan and the Fed are talking tough but acting like powder puffs in their so-called "battle" against the current forces of inflation. What has happened, of course, is that the Fed has simply followed the lead of the money market to somewhat higher rates.

Next, Julian's question as to whether I would favor bonds in the face of a gathering recession (a recession, brought on, presumably, by the Fed's tightening money policy), my answer is that if a recession arrives, my big worries would be (1) federal deficits surging and going completely out-of-control -- they are almost there now anyway. (2) A dollar that might collapse despite high US interest rates, a dollar that might cave in simply because the US was seen as totally losing control of its finances. (3) A bond market wracked by US and international selling as the world loses faith in the US being able to pay off its debt in the face of a steeply deteriorating fiscal situation -- a fiscal fiasco made worse by recession.

So my answer to Julian's questions is that no, I hardly think the dollar would strengthen in the face of a US recession. Nor do I think that bonds would hold up if the dollar "goes into the tank."

Actually, my feeling at this point is that there are so many variables in the picture that the only "answer" (I should call it a non-answer) is diversification. I have said all along that "*in a bear market the one who loses the least is the ultimate winner.*" I continue to believe that.

Now diversification is, in a way, an admission of defeat. If you KNEW, if you were absolutely certain about what was coming up, you would never diversify -- you'd put your money in exactly the correct area.

But sadly I have to confess that I don't know how things are going to work out from here. But I do know a few things. For instance, I know that the US is building up unsustainable debts. I know that the US is lying in its teeth about its federal deficits. I know that the US trade balance isn't really improving. I know that many of today's highly leveraged corporations couldn't survive a recession. I know that there have always been recessions. I know that if a person or a corporation continues to live over its head -- then sooner or later there comes a time of reckoning. I know that the Fed seems committed to bailing out industry after industry regardless of the cost to taxpayers. I know that there is a limit to how long our foreign creditors will hold the currency of a nation whose finances are out of control. And finally, I know that many sophisticated observers are saying that the Bush Administration and the current Congress are not even dealing with America's deficit problems.

So in view of all this, what do I recommend? I recommend diversification, the policy of the person who doesn't like the way things are going, and yet doesn't have a blueprint for what's going to happen when the real trouble hits.

I'm tending more and more to shorter-term debt instruments and in recent Letters I've advised Treasury notes of two-to four-year maturities. That plus lots of cash (i.e., money market funds) is what I continue to advise. I also advise accumulating gold coins on a fixed-dollar per month buying program. And for those who trade the market, my advice is to hold mutual funds or stocks only as long as the PTI is in the bullish mode (i.e., holding above its moving average).

BAROMETER: The International Institute for Market Research publishes the *Pring Market Review* (PO Box 329, Washington, CT 06794). I have followed Martin Pring's work for years and have always been impressed with it. A few months ago Pring introduced his "Stock Market Barometer," which consists of 10 financial, economic and technical indicators. To list a few of these indicators, there is an adjusted M2, a cleverly adjusted yield curve, a trend of short-term interest rates, stock group momentum, and a S&P Composite based on a 9-month deviation.

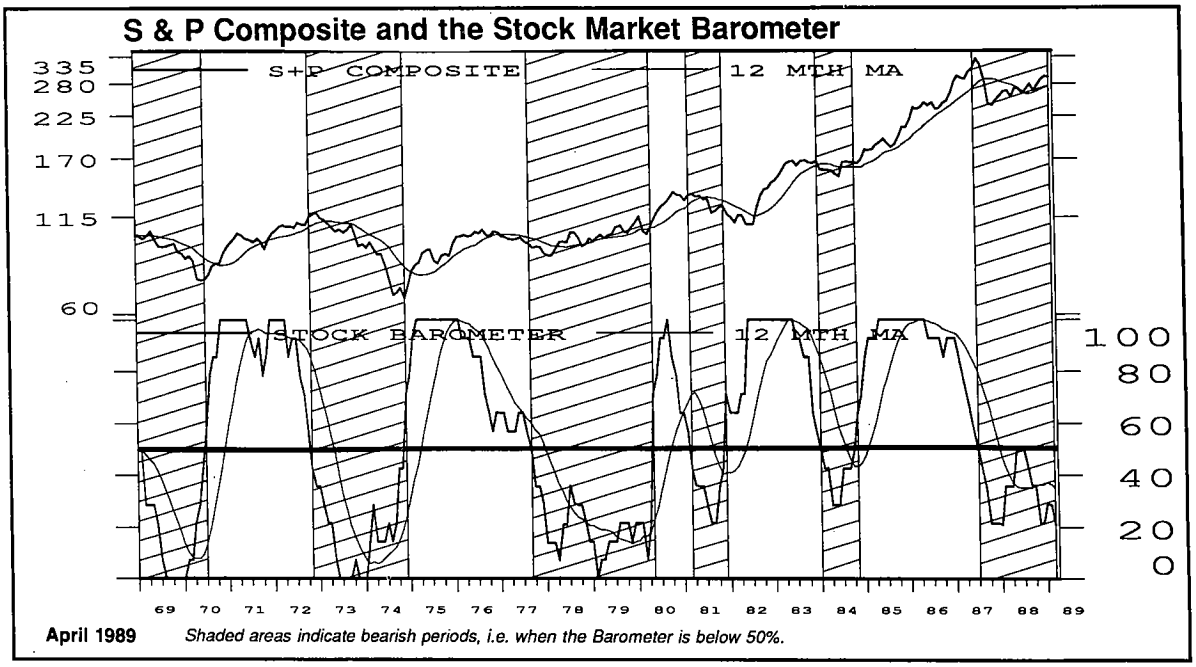
If all 10 of Pring's indicators are bullish, his Barometer will rise to 100. Any reading below 50% on the Barometer signals that the market is in a "high risk-reward" area or that the stock market itself is vulnerable. The Pring Barometer last turned bullish in early-1984. It turned bearish in June 1987 (two months before the August bull market top and four months before the crash). As you can see on the chart (top of page 4), the Barometer has been in a negative mode since June '87 (current reading is 21%).

Pring has taken his Barometer back to 1953, and he has tabulated the total return on the S&P 500 vs. the total return on the 500 using his Barometer signals. The statistics show a huge advantage if one had acted in harmony with the signals of the Pring Barometer.

I was particularly interested in the Pring study because it operates so differently from my own Primary Trend Index. The PTI works strictly on the basis of market action. Unlike the Pring Barometer, the PTI totally ignores money supply, momentum ratios, discount rate moves, Fed policy, etc. I like Pring's Barometer because it provides a background for the stock market, showing us when the risk/reward in holding stocks is favorable or unfavorable. But we must remember that stocks can advance even when the risk/reward background is poor. That's where my PTI comes in. The PTI doesn't care about risk/reward at all -- it only cares about what the market is actually doing.

Thus, I feel that both the Pring Barometer and the PTI serve very useful purposes. Right now, the PTI is saying (as it has since January 1988) that the technical understructure of the market points to higher prices. But the Pring Barometer is saying, "Play the bull side of the market if you want -- but keep in mind that the market background is HIGH RISK."

Of course, this is just about what my PTI, combined with the stock/bond ratio, is saying. In other words, the PTI continues to climb relentlessly even while the ratio of bond yields to stock yields is in the 2.5 area. Which tells us that today's money market instruments are highly attractive compared with stocks -- and that stocks are in a high risk area.



QUESTIONS and ANSWERS. Question: I'm a new subscriber, and very frankly I don't understand a lot of your technical market talk. For instance, what is the PTI and what is DowPow? For that matter, what is the Dow Theory?

Answer: Please sit tight and just keep reading. I try to explain all my indicators and all my thoughts in the course of any six-month span. In other words, within six months you should know exactly what I'm talking about. However, I do recommend keeping a back-file of the Letters. Then when I refer to an item from a previous Letter, you'll be well armed.

Question: There's been a lot of talk about the new high in the weekly advance-decline ratio, and many people say that the weekly is better than the daily A-D. What about it?

Answer: The weekly A-D ratio is simply a coincident indicator. The weekly also has one huge drawback in that it very often fails to show divergences with the Dow (which, by the way, is one of the main values of the daily A-D ratio). For instance in 1987 the weekly A-D and the Dow peaked simultaneously in August, whereas the daily A-D provided a timely warning by diverging with the Dow. Thus, those who followed the weekly Dow had no breadth warning prior to the crash -- rather a large omission! James Hughes, one of the original inventors of the A-D ratio, had no use for the weekly A-D (and I know that because I used to discuss it with him).

Question: Russell, I note that in your market analysis you favor studies based on what the market is actually doing ("action-of-the-market") rather than sentiment studies. Why?

Answer: I tend to be skeptical of market sentiment studies because they are so subjective. It's just very difficult, at any given time, to know or quantify what people are thinking and where market sentiment really is.

Of course, at certain times, sentiment becomes obvious. For instance, during June, July and August of 1987 public sentiment towards the stock market became ridiculously bullish. People were talking about "3000, 4000 and up" for the Dow, and they were buying stocks with no regard for value. At that time I took this wild optismism to be a danger signal, but such extremes in sentiment are rare indeed. But most of the time sentiment is much more difficult to decipher.

So all in all I far prefer to stay with my own action-of-the-market studies of the the averages, advance-declines, highs, momentum and lows, volume, PTI, Dowpow, etc., all indicators based not on opinion or sentiment -- but what the market is actually doing.

Question: With the massive amounts of debt that the US government must finance and service, do you think we could see the time when the government actually reneges on its debt?

Answer: No, I don't. The reason the government won't renege is simple. If they stopped paying interest on the debt they couldn't continue to borrow. And as you know, governments will do whatever they have to -- to perpetuate themselves. As things stand today, our government must borrow to survive.

Actually it's conceivable to me (say during the depths of a monetary crisis) that the government might declare a temporary moratorium on paying off the principle on its bonds, but it would certainly continue to pay interest.

Question: Speaking of reneging, can you envision the government confiscating or forcing a turn-in on gold as occurred during the early 1930's?

Answer: Again, my answer is no. The US in 1974 reversed its stand on gold and allowed its citizens to legally hold gold in all forms. Furthermore, the US actually encouraged its citizens to buy gold in the form of newly-minted US gold coins. It's inconceivable to me that we would see a reversal of that policy. Besides, what would be the purpose at this point of banning gold? The world is no longer on the gold standard and claims against the US are made in dollars, not gold. Finally, I don't believe today's holders of gold and gold coins would turn in their gold -- even if the government demanded that they do so.

NOTES AND QUOTES: Economists are worried about economic polarization. Translation: There is a growing disparity in the US between the rich, who are getting richer, and the poor, who are getting poorer. As I see it, the real story could be that the disparity is between the savers and the debtors. As interest rates stay high, the savers are having a picnic and getting richer, while the debtors are paying through the nose and getting poorer. If you're a saver and are compounding your money (as I have been advocating for years), it's feeling like Christmas time. On the other hand, if you're heavily in debt, you feel like you just stepped into a bear trap.

The following was written by Paul Samuelson, Nobel Prize winner in Economics (from the April 4 *Christian Science Monitor*): " 'Once

the do-nothing President Reagan retires, the pragmatic President Bush will begin to get a handle on the budget deficit and the balance-of-payments deficit.' Remember those cheery Wall Street predictions? How do they score two months into the Bush presidency? Alas, the realists are proving to be right. The election-period hot air is revealing itself to be only hot air. (1) The Bush plan for a flexible freeze of budget expenditures aimed at avoiding new taxes, is getting nowhere. Neither party in Congress takes it seriously. (2) The Bush proposal to cut the capital gains tax down to 15% looks dead in the water. . . . In short, the Bush program is so far, deja vu, the Reagan program all over again. However, I see no convincing signs that the public is blaming George Bush for anything, any more than they blamed Ronald Reagan, the 'Teflon president.' " Samuelson then goes on to say that he "fears stagflation." On the cheery side, he opines, "The Bush team is certainly, on the average, not as incompetent as the Reagan team was, nor is it as ideologicial."

* *

In the meantime, the influential and widely-read London *Economist* is taking a palsied look at the way things are developing in America. The following is from the March 31 issue:

> PITY Mr Alan Greenspan. In an ideal world the chairman of the Federal Reserve would use his influence over America's monetary policy to force President Bush and Congress to do the right thing over their budget deficit—and fast. The threat of sharply higher interest rates could act like a hangman, concentrating minds. But the world is not ideal. Worry as he might about inflation, Mr Greenspan cannot risk raising interest rates too sharply for fear of causing financial collapse, inside America as well as in the third world. Unwittingly, that restraint permits America's politicians to drift blithely on, refusing to raise taxes (read Mr Bush's lips) or to cut spending (ask Congress's voters). The only thing that will concentrate such minds is a crisis.

* *

Out of New York comes the wisdom of Jim Grant (*Grant's Interest Rate Observer*, 233 B'way, NYC 10279), and I can tell you that Jim isn't happy about the future of US bonds. He writes, "One bearish influence is the growing socialization of credit risk. If the government is going to guarantee an ever-lengthening list of private debts, the government must itself become less creditworthy." . . . But, asks Jim, "If the US government is a worsening credit, why has the dollar been appreciating against gold and the so-called hard currencies? That objection is well taken, and we can only answer by falling back on the old chestnut, 'The fundamentals will out.' "

* *

What are the fundamentals? Here's an important one: the "official" federal debt is now running around $160 billion (well over Gramm-Rudman), but the real deficit, when you add the amount raided from Social Security and the increase in debt taken on by other federal agencies, is running OVER $300 billion (that's $5.7 billion a week!). How long will our creditors continue to buy our Treasury bonds and notes? Your guess is as good as mine.

* *

Squeeze: About 25% of all mortgages outstanding are adjustable rate mortgages. A homeowner who took out an ARM $100,000 mortgage in early-1987 at an initial 7% rate paid $665 a month. Last month (in March) the rate rose to 11% and the ARM owner paid $945 a month on his mortgage -- a boost of 42% over 1987.

* *

Statistics: NYC (the City, not the state) faces a $1 billion deficit in the coming fiscal year. . . .16,000 people died violent deaths in Colombia last year, 1,000 were political murders, the rest gangster/dope connected. . . . Motorcycle import sales are down 30% over the last few years. Only America's Harley Davidson is still booming. On the West Coast, Harley's are a craze.

* *

Don Bauder, financial editor of the *San Diego Union,* is one of the few newspapermen I know who is smart enough and courageous enough to "tell it like it is." In a recent column, Don notes that among the signers of the recent "Mike Milken, we believe in you" ad were Irwin Molasky and Merv Adelson, longtime Milken associates, and La Costa founders and men who have been financed by the Teamsters Central States pension fund. In a 1987 *WSJ* ad (via Drexel Bunham) other signers (all members of the Las Vegas/Wall Street nexus) were Henry Gluck of Casear's World Casinos, Richard Gillman of Bally's Park Casinos, Michael Rose of Holiday Corp. Casinos, William Barnet of Circus Circus, Robert Mullane of Bally, Stephen Wynn of Golden Nugget Casinos, and Meshulam Riklis, casino owner.

"Overall," writes Bauder, "the members of the Hollywood/Las Vegas nexus were crucial to Milken's operations, making raids on US corporations, buying junk bonds to help finance raids or generally doing Milken's biddings. . . . During this insanity equity was being replaced by debt -- and junk debt at that . . . The government is prosecuting Milken, yes. But is anyone doing anything about our wacko tax code that subsidizes debt and punishes equity? Not really. Is it looking at the gross abuses in hostile takeovers or the fact that we taxpayers subsidize LBOs? Not really. Throughout its incumbency, the Reagan Administration constantly sided with the raiders/arbitrageurs/LBOers and their friends in the gambling profession. George Bush says that US business is too short-term results-oriented and that's why we're losing to Japan. He's right. But he's partly to blame. In an era of eat or be eaten, run your stock up to be taken over, there is no time to build companies or contribute to your country's economy. There is only time to manipulate earnings, pile up leverage, shuffle assets -- everything but invest in the future." Editor Don Bauder doesn't mince words. That's what makes him a top newspaperman.

* *

I went to the opener of the Padre's baseball season a few weeks ago. I'm embarrassed to reveal this, but my wife, Faye, insisted on it, so here goes. The last pro baseball game I attended was at Yankee Stadium about 55 years ago. Carl Hubbel and Lefty Gomez were pitching. My father said, "Dick, see that chubby guy coming up to bat. That's the Bambino, Babe Ruth. Now watch, he's going to hit a home run." And by gad, that's exactly what he did -- on the first pitched ball.

* *

Speaking of sports, its a sad good bye to the best boxer who ever lived -- Sugar Ray Robinson died on April12. Ray was one of my idols. He was a tiger; he was poetry in motion; he was an athletic genius who fought more fights over the age of 40 than Sugar Ray Leonard has fought in his whole life. Many's the time I would see Ray's purple-pink Cadillac convertible roll through the streets of New York. We'd always wave to him. If Ray saw us, he'd smile and wave back. Ray was king of the ring, and the prince of the city.

* *

As I have long predicted, the Russians are serious about a convertible ruble. A few weeks ago, Soviet economist Abel Aganbegyan told reporters that a convertible ruble could be partly based on the gold standard and the Soviet Union's hard currency reserves. The Russians need a convertible ruble for their new foray into world trade. Russia is pushing hard for joint ventures with Western firms. So far, West Germany is in the lead with $66 billion spent on Russian ventures, Italy is second with $62 bilion, and Yugoslavia and France come in next with $43 billion. US firms have so far invested $22 billion in joint ventures.

* *

California now has a population of 28.3 million. Ponder this --one out of every nine people in the nation now live in the Golden state. The population in California (during the single year ending last July) jumped an incredible 662,000 with every county gaining except for the San Francisco area. SF is getting crowded, and in a recent poll the majority of SF residents stated that they would prefer to live elsewhere.

* *

What's happening in Japan today is just short of fantastic. A new tax law allows Japanese stock market operators to choose between a 26% tax on capital gains or pay a 1% tax on all stock transactions. The 26% option means going to the tax office and revealing all income sources, but the 1% solution allows people to trade their heads off without revealing the source of their capital (90% of the

transactions are now taxed at 1%). One result of the new law is the release of a huge pool of underground money -- a pool estimated at $750 billion (much of it from black market land and real estate speculation). Said one observer, "Individuals can now openly use all this underground money. The money equals 20% of the market capitalization and more than 25% of Japan's gross national product. It's turning the Tokyo stock market into a vast money-laundering machine. Traders can now buy a Jaguar or a Mercedes and say they made the money in the stock market."

* *

Japan orders schools to fly national flag

TOKYO (Reuter) — Japan's education ministry said yesterday that elementary and junior high schools will have to fly the national flag and sing the national anthem at all major ceremonies from next year.

Some schools at present refuse to use the flag and anthem because they are seen by many people, including the main teachers' union, as symbols of Japan's imperialist past.

"We want all children to cultivate a better understanding of Japan by doing this," a ministry official said.

If you survived combat in World War II (as I did), you probably have a different perspective than most people -- at least in certain areas. So let me say that I wasn't exactly thrilled by this little news clip:

NEXT MAILING: May 3

GOLD: What's happening to gold and the precious metals can hardly be called exciting. But maybe we should be thankful for gold's lack of action. Occasionally a subscriber will ask me, "Russell, I'm continuing to accumulate gold coins as you suggest. But when do you think the metal is really going to take off?"

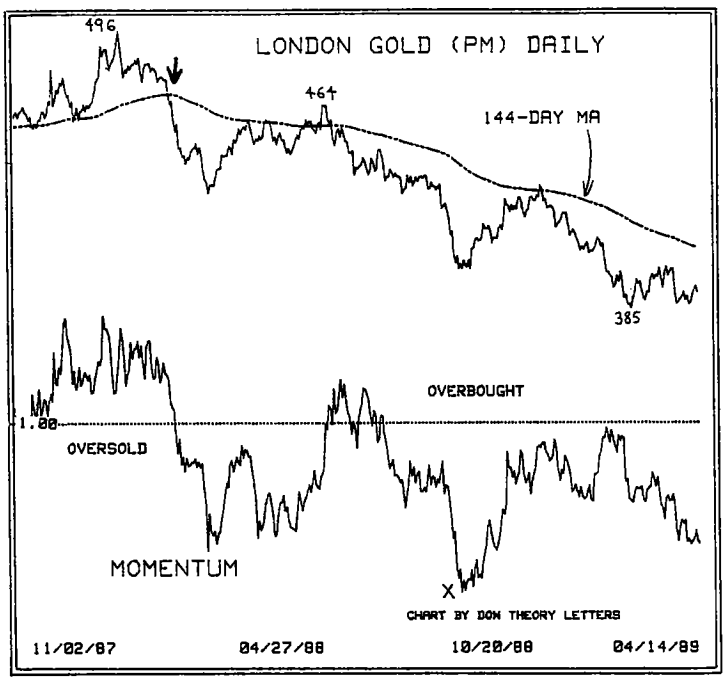
"Oh," I answer, "you mean when will the dollar collapse? Gee, I don't know, but I hope it's not this year." That usually produces a smile of belated recognition from the questioner.

We buy gold for insurance purposes. If you take out a life insurance policy on your spouse, you don't (I trust) sit around hoping that your beloved spouse will float heavenward in the near future. The same thinking should apply to gold. Gold is the ultimate money. Personally, I buy it and hold it because I see what Mr. Reagan and Congress did to the deficit, and I see what George Bush and Congress are doing (or not doing) to the current deficit. With any luck the true deficit in Bush's first year will come in under $300 billion, but don't count on it (and I'm serious).

The fact is that the US is digging itself deeper and deeper into a massive debt-hole, and the deeper it sinks, the harder (more impossible is the word) it will be to get out. If Washington has ultimately to chose between inflation or deflation, there's no question in my mind but that it will pick inflation. Of course, Washington may not have a choice -- the markets may do the final choosing.

At any rate, I will continue to accumulate gold. Despite what you hear, the real moves in gold have nothing to do with the amount of gold produced or the gold/dollar ratio. The real moves (remember 1977-80) have to do with human emotions and hysteria. Remember the expression that was on everyone's lips in 1979 -- "There's no fever like gold fever." When gold does move, if you're not in it, the chances are that you're going to be left behind at the starting gate. People try to analyze gold on the basis of ratios and world production schedules and whether the Russians are selling or holding back. Forget it -- gold moves on emotions. Which is why I say, "Buy gold when no one wants it and when emotions are cool to cold." Now is one of those times.

Of late, gold has stopped going down. That, by the way, is the first step in a reversal from a bearish condition to a bullish condition. The chart (above right) shows gold in early 1988 breaking below its 144-day moving average (down arrow) and holding below the



moving average ever since. However, of late gold has been moving sideways while fluctuating in the 380-385 area.

The lower portion of the chart shows gold momentum (89-day rate-of-change), and here we see the deep oversold area of late-1988 (X on chart) and the more recent decline in momentum -- again to oversold territory. Note that over the last year gold has registered three oversold modes on momentum without once going to a substantially overbought mode. This is an indication that the metal is becoming sold-out (i.e., exhausted on the downside).

Gold will be graded bullish if or when it moves above its moving average and when, at the same time, gold's momentum rises over 1.00.

LATE NOTES: The climb of my PTI since January 1988 (when it first turned bullish) has been as relentless as any time in its 18-year record. Has all this upside action been merely a reaction to (or correction of) the greatest crash in Wall Street history — or is there something else in the wind? And if there is "something else," what could that something be? Could it be the pressure of a tidal wave of international money coming to the US to buy bargains. Could it be visions of global prosperity or even global inflation? Could it be that the Fed or the administration have discovered the secret of eliminating recessions?

Only time will provide the answers, but there is no questioning the power and upward drive of the PTI. As has happened so many times in the past, the PTI is proving to be smarter and more prescient than its creator. For all our new subscribers I should repeat that the PTI is an emotionless, remorseless indicator, and despite the fact that I compute it daily it seems to have a life and brain of its own.

On March 13 the S&P 500 and the NYSE Index both bettered their February peaks, thereby breaking out above their three-month trading range. The obvious expectation would be for the D-J Industrial and Transportation Averages to follow. And if that happens the expectation would be for higher prices across the board.

MONEY: Last week (as the Milken affair deepened) junk bonds got hit and hit hard. Some of the retail junk bonds pushed into the 16% to 20% area amid a news report that over a 10-year span up to 31% of junk bonds went belly-up.

Thus, the spread between the junk bond yields and Treasury yields widened considerably last week. Also widening was the spread between Treasuries and mortgage-backed securities.